# Overview of the Springfield Police Officer's and Fire Fighter's Retirement System

# Overview

- Background
  - Types of Systems
  - Police and Fire Benefits
  - Plan Structure
  - The Fund
  - Plan Funding
- How did we get here?
- Board Overview and Recommendations

# Background Information

# Types of Retirement Systems

- Defined Contribution
- Defined Benefit

# Why Defined Benefit over Defined Contribution?

- Encourages long-term employment
- Reduces turnover
  - reduces staffing shortages
  - decreases inexperience
  - reduces costs since training is extensive and expensive

# Police & Fire Benefits
**(Pre-2006)**

- Not covered by Social Security
- Multiplier is 2.8% per year of service
- Average final salary is average of 3 highest years of the past 10
- Maximum of 70% of final average salary
- Eligible when any of the following are met:
  - 25 years of service
  - Age 60 (mandatory)
  - 20 years of service and age 50
- 3% COLA after age 56
- Employee’s contributions returned upon retirement

# Police & Fire Benefits
## (Pre-2006)

- Example:
  - Someone starting at age 30 retiring at age 50 with a final average salary of $48,000 per year would receive 56% of their salary. This would be $26,880 per year and would get their first cost of living raise 6 years later.

# Police & Fire Benefits
**(Post-2006)**

- Not covered by Social Security
- Multiplier is **2.5%** per year of service
- Average final salary is average of 3 highest years of the past 10
- Maximum of **75%** of final average salary
- Eligible when any of the following are met:
  - Age 60 (mandatory)
  - **25 years of service and age 55**
- Up to 3% COLA after age 56

# Benefit Comparison (Pre-2006)
## 11-City survey and LAGERS

- Social Security
  - Like Springfield, most do not receive Social Security
- Retirement Eligibility
  - Oldest minimum retirement age
  - Second highest minimum years of service
  - Average minimum years of service/age combination

# Benefit Comparison (Pre-2006)
## 11-City survey and LAGERS

- Multiplier
  - Slightly higher with additional multiplier paid by employees
  - Slightly below average without it
- Maximum Benefit
  - Second lowest

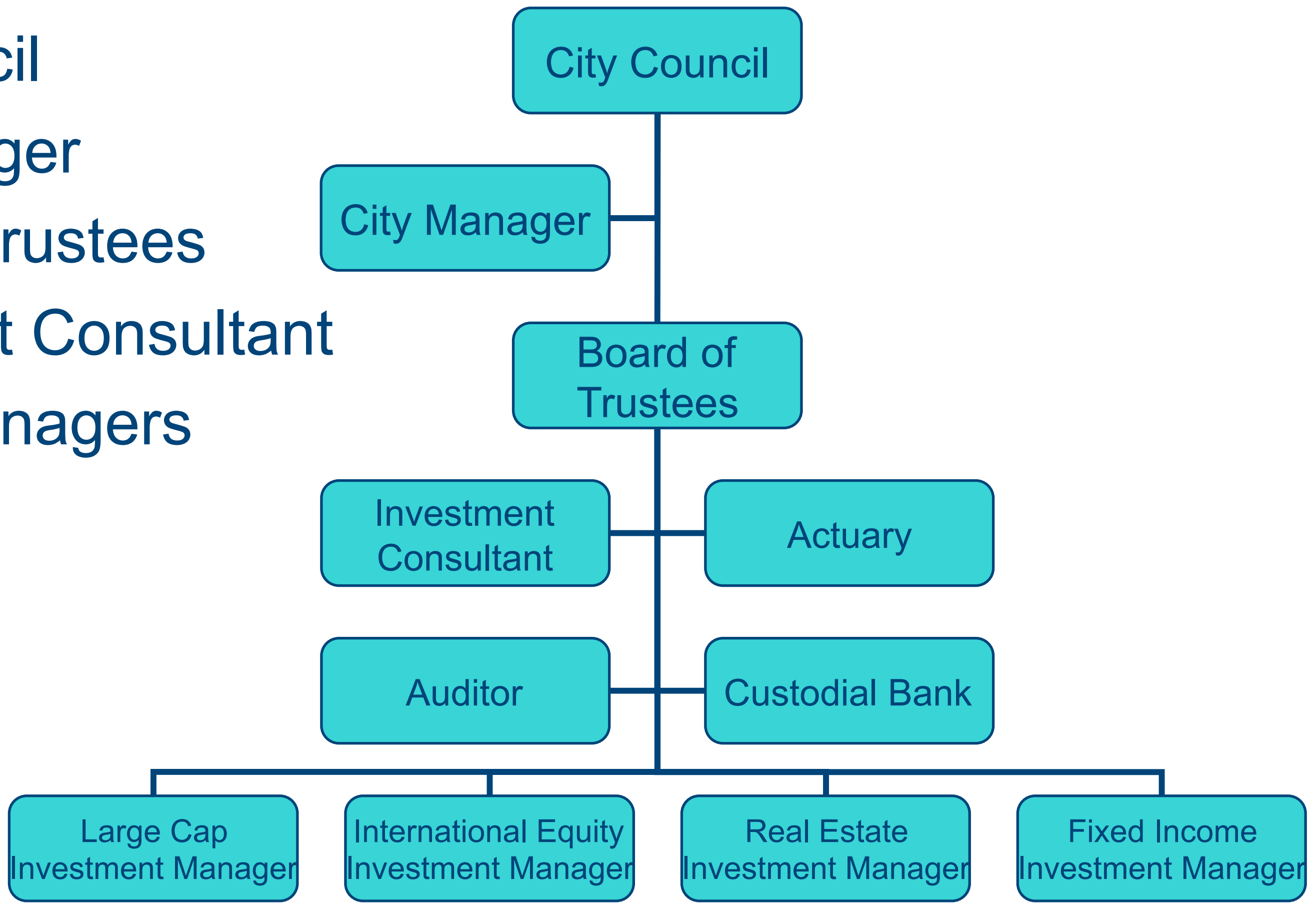
These two factors cause Springfield to reach their maximum benefit quicker

# Benefit Comparison (Pre-2006)
## 11-City survey and LAGERS

- Escalation (COLA)
  - Average amount per year
  - Highest minimum age eligible for escalation
  - Most plans are at any age
- Return of Contribution
  - Fairly unique
  - Several others have other types of lump-sum payout
    - DROP
    - Lump-sum in lieu of full monthly benefits

# Plan Structure

- City Council
- City Manager
- Board of Trustees
- Investment Consultant
- Money Managers
- Auditor
- Actuary



# City Council

- Sets plan provisions and benefit levels
- Sets investment policy
- Determines City contribution level

# City Manager

- Recommends amount of contributions for the plan to the City Council through the budget process
- Can appeal Board disability determinations

# Board of Trustees

- Administers plan provisions
- Develops investment levels within policy
- Determines actuarial assumptions
- Makes recommendations to City Council on the plan

# Board of Trustees – Voting Members

Voting Members

- Deputy City Manager
  - (President)
- Police Representatives
- Fire Representatives
- Retiree Representative
- Citizen Representatives
- Finance Director
- Human Resource Director

Non-Voting

- City Council Member
- City Attorney
- Board Secretary

## Portfolio Management

- Investment Consultant – Gino Reina, Segal Inv.
  - Investment Consultant provides advice, but Trustees make all decisions
  - Investment Consultant provides oversight of the Investment Managers
  - Assists with Investment Manager selections
  - Paid a flat-rate, per negotiated, fee schedule

# Portfolio Management

- Investment Managers – Vary by Asset Class
  - Study their specific asset class and determine what to buy, when to buy, and when to sell.
  - There are a variety of styles of making those determinations
  - They direct Account Custodian to allow the actual trade to occur
  - Paid based on basis points (bps) which is a fraction of a percent of each dollar under management

## Portfolio Management

- Account Custodian – US Bank
  - Where our assets are actually held
  - Includes both cash and investments
  - Works with the Director of Finance in managing the actual bank account
  - Acts at the direction of the Investment Managers
  - Pays all fees associated with the investments

# Auditing

- Fund Auditor – Davis, Lynn & Moots, PC
  - CPA audits the fund to ensure
    - Fund is properly represented by financial statements
    - Funds are not missing
    - Funds are invested within the policy
    - Recommends accounting safeguards
  - Prepares an annual audit each Fiscal Year
  - Paid flat-fee

## Actuarial Evaluation

- Actuary – Michael Zwiener, Milliman Consultants and Actuaries
  - Uses assumptions to make predications about the future
  - Assumptions are set by the Trustees based upon recommendations of the actuary
  - Estimates future value of assets and liabilities of the plan to calculate the required contribution rate to fund the plan
  - Paid flat fee

# The Fund

# Plan Fund

- Trustees have full investment discretion within the City Council approved Investment Policy
- Investment Asset Classes
  - Equities (45%-75%)
  - Fixed Income (25%-40%)
  - Alternatives (0%-15%)

# Risk

- In general, greater returns require greater risk
- Goal is to maximize risk-adjusted rates of return
- Risk can be reduced through diversification
  - Diversifying between Equities, Fixed Income, and Alternatives
  - Diversifying between domestic and international
  - Diversifying between company size
  - Diversifying between sectors
  - Diversifying between Growth and Value style equities
  - Limiting exposure into any one security

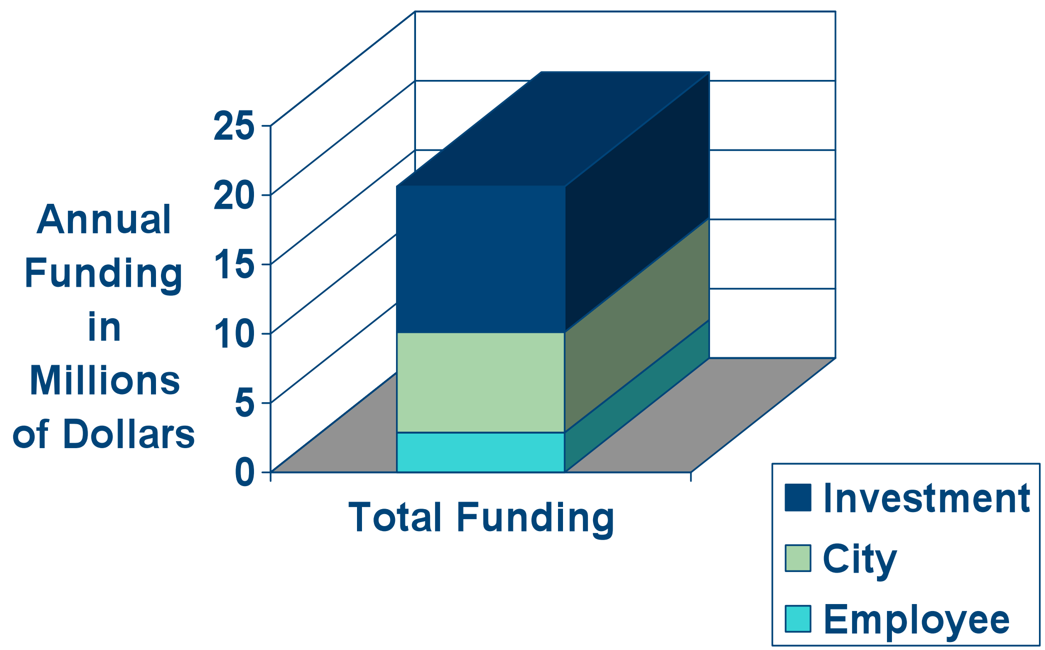
# Plan Funding

# Plan Funding

- Employees contribute a fixed amount
  - Those hired prior to July 1, 2006 contribute 11.35% of their earnings.
  - Those hired after July 1, 2006 contribute 8.5% their earnings.
- City contributes the actuarially determined rate of payroll to fund the plan, subject to the budget process and approval by City Council.
- The Fund earns returns on invested assets with an assumed rate of 7.5% of assets.

# Plan Yearly Contributions

- Employee Contribution
- Employer Contribution
- Return on Investment



# Actuarial Evaluation

- Assumptions:
  - Assumed rate of return (ROI)
  - Life spans
  - Retirement rates
    - Normal service
    - Disability
  - Payroll increases
  - Pay increases
- Amortized over 30 years
- 4-year rolling average (smoothing) of returns
- Projections made based upon all currently accrued liabilities.

# How did we get here?

# Timeline

- 1988 - City Council establishes
  - four-year cycle of reviewing assumptions
  - assumptions including an investment return of 8.0% (raised from 6%)
  - standardized method of valuation
  - funding policy established to include funding to actuarial rate
- 1991-93
  - change in multiplier from 2% to 2.5% per year of service phased in over 3 years
    - 1.5% increase in employee contribution
  - change in assumptions including investment assumption to 8.5%
  - Board votes to allow up to 5% in small cap stock
- 1994
  - Change to equalize disability benefits with normal service benefits
  - Change to payout excessive leave balances

# Timeline

- 1995
  - added return of contribution (3.7% cost covered by City)
  - restriction on vacation accumulation for new-hires
- 2000
  - Tech bubble correction
  - Increase in multiplier from 2.5% to 2.8% per year of service. (2.14% cost paid by employee)
  - Change in Board composition removing the Council member and the police or fire chief and adding three private citizens
- 2001
  - Stock market decline (9-11)

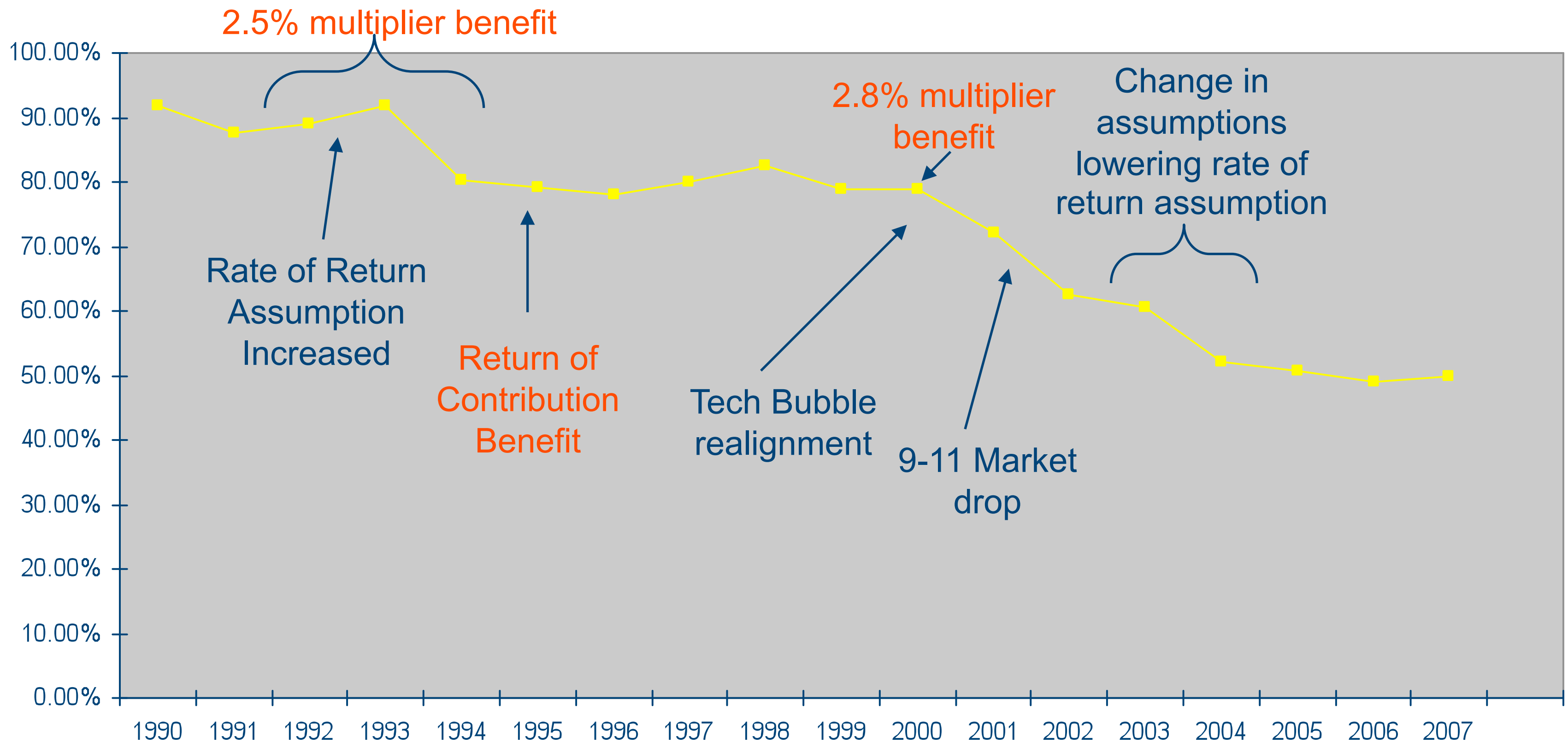
# Timeline

- 2003
  - Change in investment policy to allow 40%-60% of fund to be invested in equities
  - Discussed projected contributions w/City management
  - Investment return assumption reduced to 8.25%
  - Change in GASB requirement for 30 year amortization
- 2004
  - Realigned several assumption criteria including reducing the investment return assumption to 7.5%
  - Changed disability loophole unintentionally created in 1994
  - Holiday accumulation caps for all new employees implemented
  - Reduction in holiday accumulation for current fire employees
- 2005
  - City does not fund required contribution rate creating NPO of $523,138

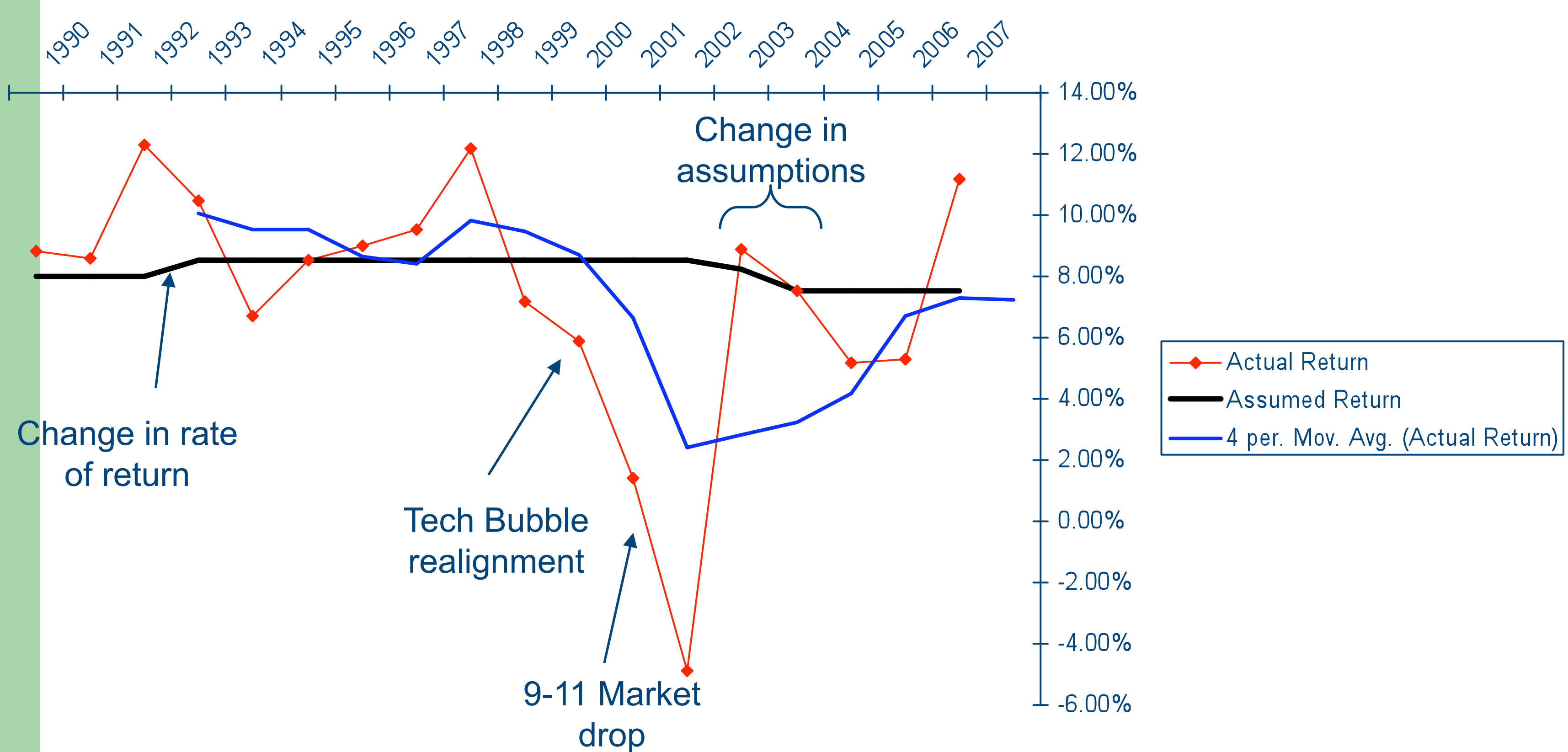
# Timeline

- 2006
  - Change in Board composition
    - removing police or fire chief
    - adding Director of Finance, Human Resource Director, and the City Manager or his designee (as President) as voting members
    - adding City Council member as a non-voting member
  - Reduced pension benefits of new-hires
  - Change in investment policy to allow:
    - 45% - 75% in equities
    - 25% - 40% in fixed income
    - 0% - 15% in alternative investments
- 2007
  - State law enacted requiring funds under 60% funded must make the full contribution requirement within a 5 year period

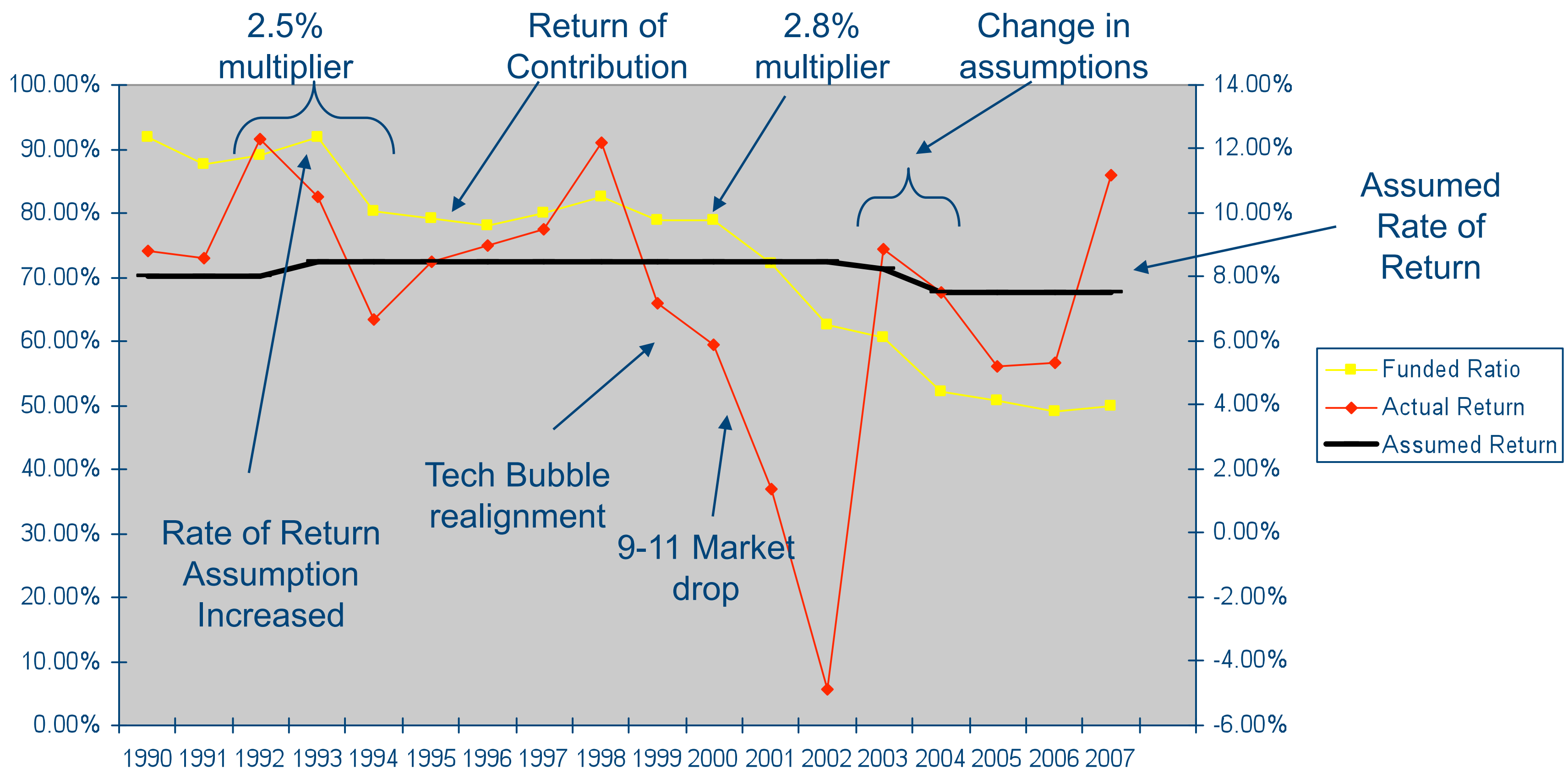
# Funded Ratio



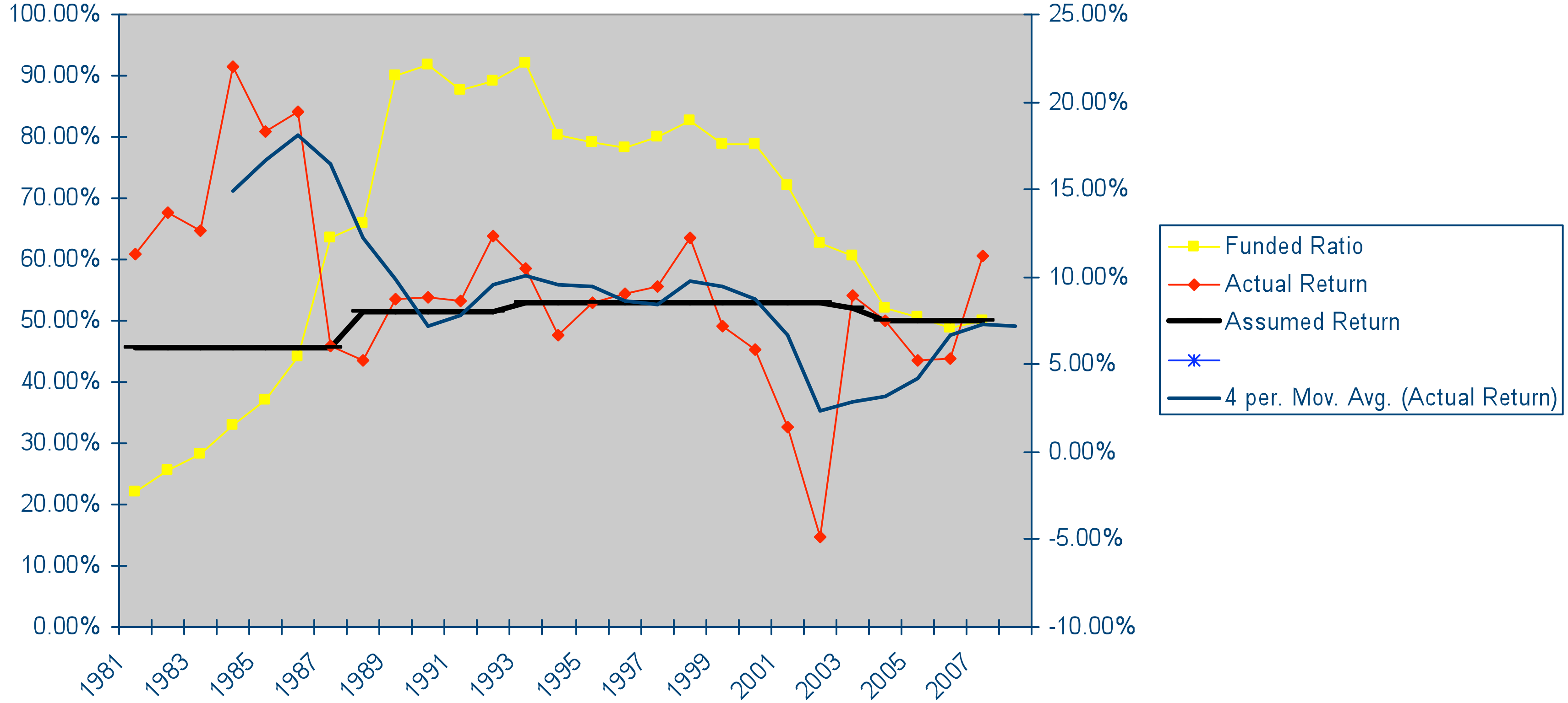
# Rates of Return



# Funded Ratio



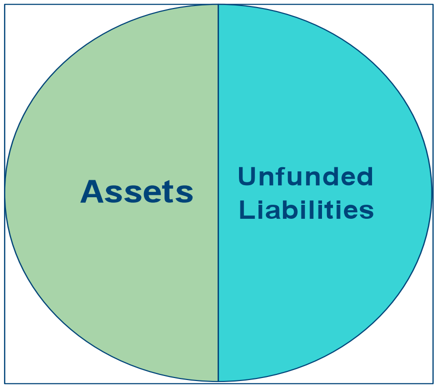
# Funded Ratio



# Example of Funded Ratio Effects

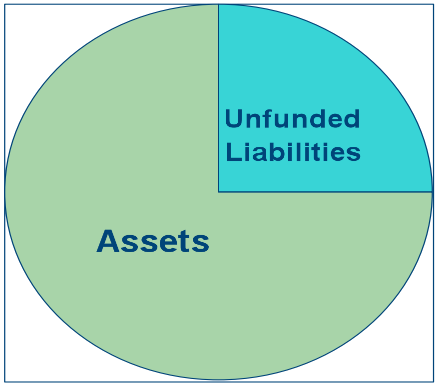
Assuming a plan has $200 million in liabilities

50% Funded Plan




At 50% funded, it earns
$7.5 million returns

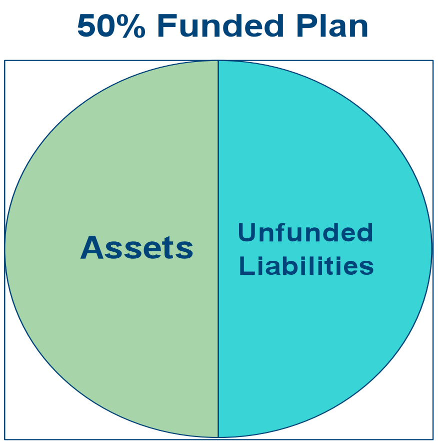
75% Funded Plan



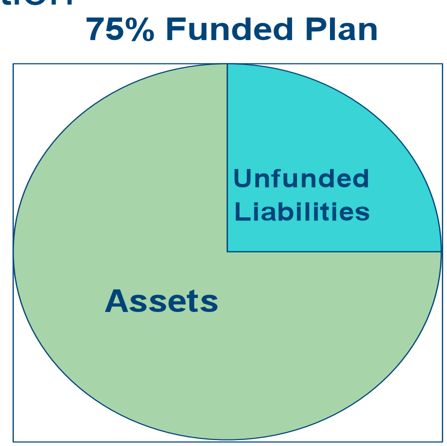

At 75% funded, it earns
$10.75 million returns

# Example of Funded Ratio Effects

Assuming a plan has $200 million in liabilities
with a 20 year amortization

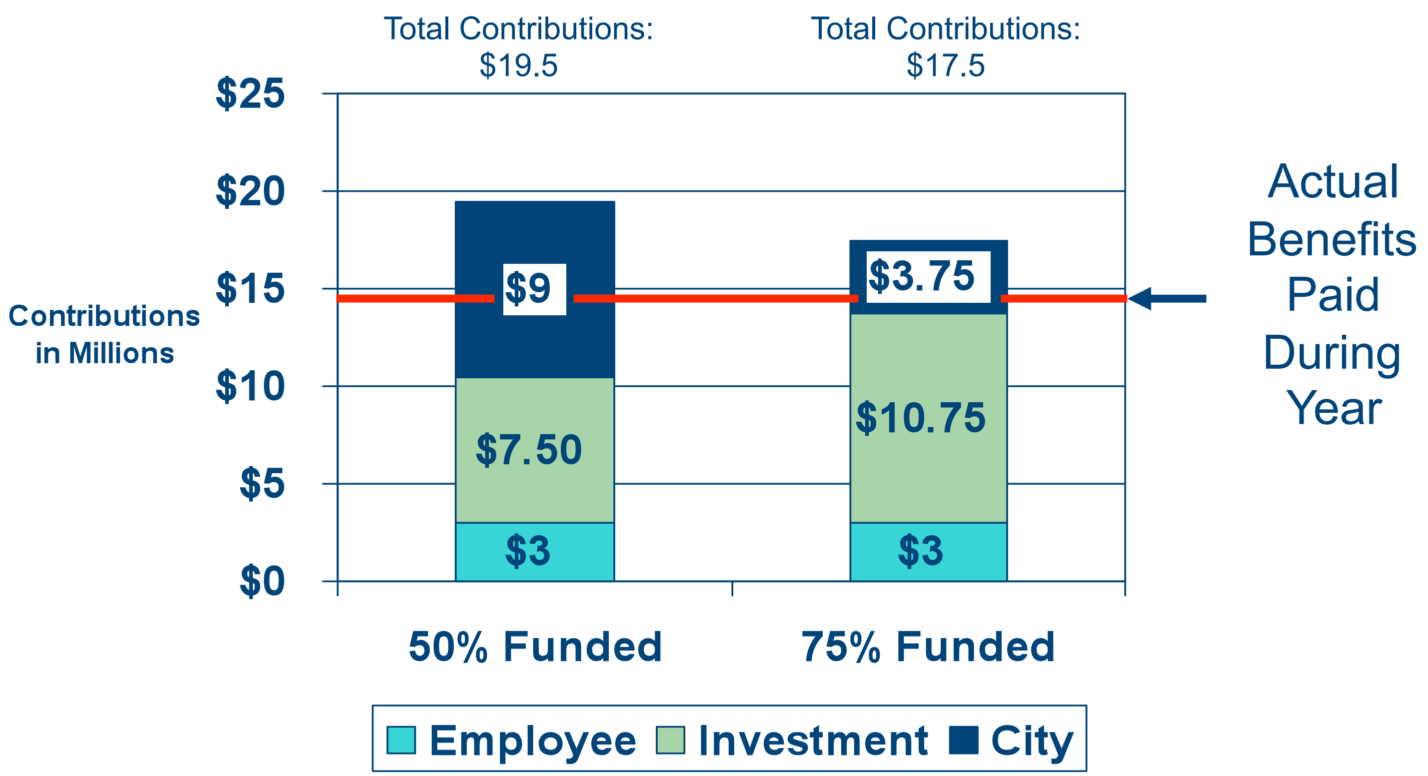



At 50% funded, the amortization principal is $5 million per year

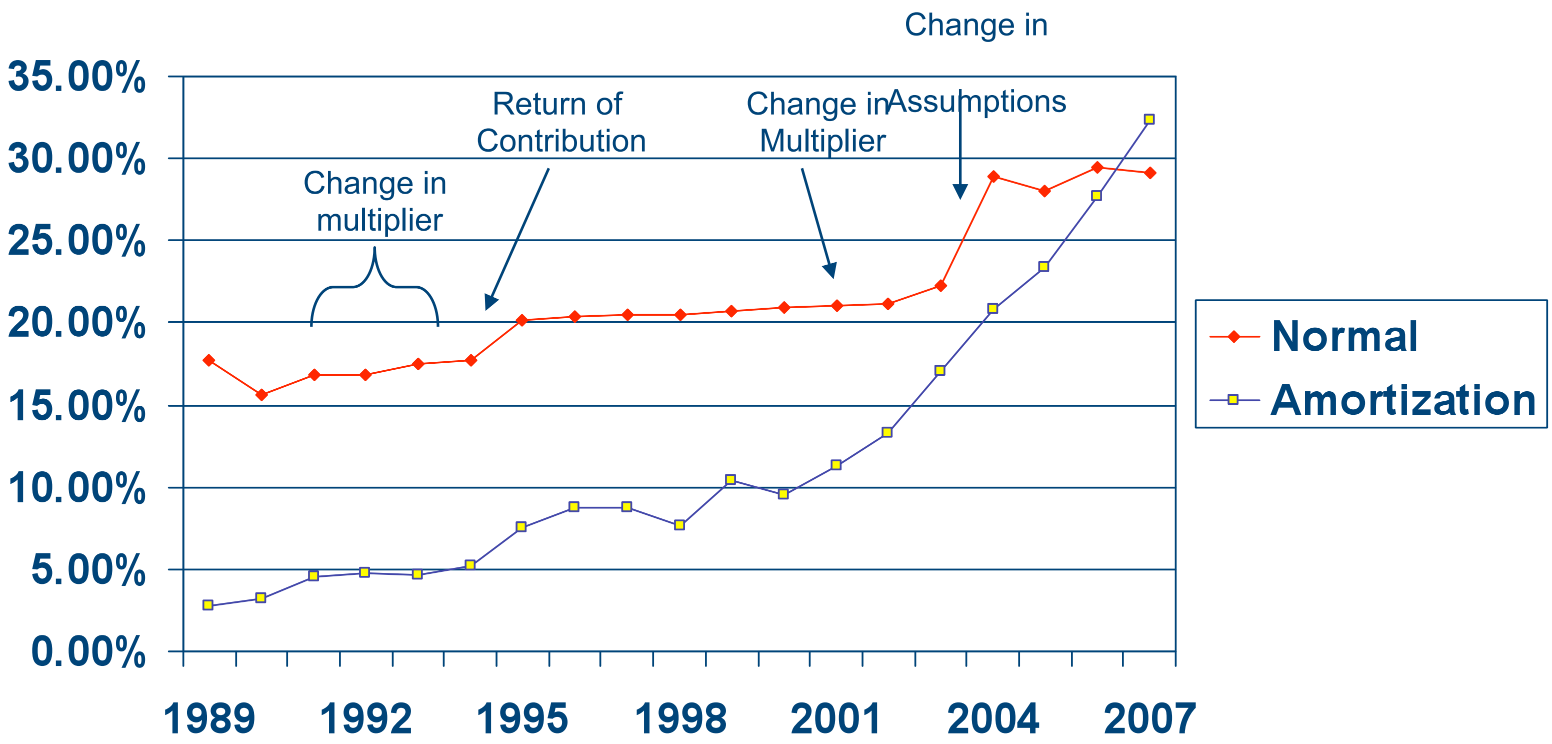



At 75% funded, the amortization principal is $2.5 million per year

# Example of Funded Ratio Effects



# Plan Costs



Change in
Assumptions
Return of
Contribution
Change in
Multiplier
Change in
multiplier
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
1989
1992
1995
1998
2001
2004
2007
Normal
Amortization

# Board Overview and Recommendations

# Board Assessment

- 2005 the Board contracted for an independent performance audit which recommended:
  - Development of Council policies which
    - Delegate responsibility and accountability to Board for investment issues
    - State role of City Attorney and Finance Director in representing the City's interests
  - Have an Asset Allocation or Asset Liability study conducted
  - Upgrade Investment policy
  - Renegotiate vendor contracts to reduce fees

# Board Assessment

- 2006 Actuarial valuation listed four ways to improve the funded status
  - Increase investment returns
  - Increase contributions
  - Reduce future liabilities
  - A combination of the above

# Actions Taken

- Board has been restructured
- New investment consultant hired
- Asset allocation study conducted
- Investment policy revised
- Investments restructured to increase expected returns
- Investment fees have been reduced by 30%

# Actions Taken

- City increased its contribution rate to 28.88%
- Council appropriated an additional $500,000 in the 2008 budget.
- Council appropriated the $500,000 reserve from a settled lawsuit potential on overtime.
- City has addressed issues affecting funding including:
  - Vacation (1995) and Holiday (2004) accumulation caps
- Benefits reduced for those hired after June 1, 2006

# Results

- Funded ratio has continued to deteriorate but at a slower rate.
- Everyone has agreed that investment returns alone is not able to fix the plan
- To prevent an NPO, the City contributions were increased to over 50% beginning July 1, 2008 which resulted in substantial budget cuts and reductions in services

# Impact of Not Securing Additional Funding

- The contribution rate will continue to grow without an infusion of funds
- More substantial budget cuts in addition to the current cuts
- Impact the City's bond rating
- Staffing reductions
  - result in fewer paying into the plan making the system worse
  - May affect fire insurance ratings
- Inability to provide cost-of-living raises will
  - impact employee recruitment and retention
  - Increase pension contribution rates

# Potential Solutions

- If the City only contributes 28.88%, the plan will deplete in about 20 years
- If the City pays the full required contribution rate by 2015 the plan will have reached 70% funded but the contribution rate will reach 80% of payroll and the plan would not reach 90% funded until 2031
- Benefits accrued must be paid. Reductions in future benefits require a vote of the people and would be subject to legal challenges.

# Potential Solutions

- The plan could be closed to new participants or left open. Should closing the plan be considered, it should be studied <u>extensively</u> prior to making the decision due to the likelihood of additional impacts. Funding will still be needed.
- Pension obligation bonds could be issued however it is more expensive, requires a longer period to repay, and adds risk.

# Potential Solutions

- By meeting assumptions and passing a sales tax, the plan will be funded to 90% in:
  - 1% tax will take just over 3 years
  - ½% tax will take 8 years
  - ¼% tax will take 19 years
- If poor economic returns and passing a sales tax, the plan will be funded to 90% in:
  - 1% tax will take just over 3 years
  - ½% tax will take 16 years
  - ¼% tax will only reach 55% in 30 years

# Recommendations

- A sales tax of at least ½% sunsetting when the plan is at least 90% funded
- City commits to maintaining a funding level of at least 28.88% as long as the tax is in place
- After the tax ends, the City is required to make the actuarial required contribution for all future years

# Recommendations (cont)

- A portion of all future cell phone settlements should be directed into the plan
- Reductions in the general fund should be revised to a level that does not impact core services
- The City needs to review the disability process by making reasonable accommodations to retain injured employees

# Summary

- DB plan increase recruitment and retention
- Springfield provides an average level of benefits
- Funding must be provided to keep the system from running out of funds in 20 years.
- Changes have been made:
  - Benefits for new hires have been reduced
  - Limits implemented for Vacation and Holiday accumulation for current employees
  - Plan management fees have been reduced
  - Asset allocation has been made to increase returns
  - Contributions by the City have been increased

# Summary (Cont)

- Significant reductions in service will be required without additional funding
- Solution
  - A sales tax should be passed during which City funding is set at the highest level without impacting core services
  - Any settlement funding should be put in the plan
  - Safeguards should be included to prevent reoccurrences
  - Accommodations should be offered to disabled employees

# Police Fire Pension Board

Questions?